The Pandemic's Impact on Central Europe in a Historical Perspective

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Central Europe is a denotement in EU-speak that refers to Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovakia, in order to distinguish them from other new members of the European Union in the Baltic or Adriatic regions. Geographically, other countries (Austria and Liechtenstein) also belong to the region but are rarely grouped with these six.

In the last 30 years all European ex-communist economies have proved a remarkable success, performing on almost all economic indicators, except productivity, better than the economies of Western Europe. According to IMF and World Bank definitions, these countries used to fall into the groups of both "developing" and "emerging" economies; now all of them, except Bulgaria, belong to the category of "high income" and the Czech Republic and Slovakia are already developed nations, and the Czech Republic is not counted as an emerging market.

The intention of this article is to give additional insights into the backgrounds and impacts of Covid-19 on emerging and developing economies, including the prospects for recovery of Central Europe.

The Second Half of the 20th Century

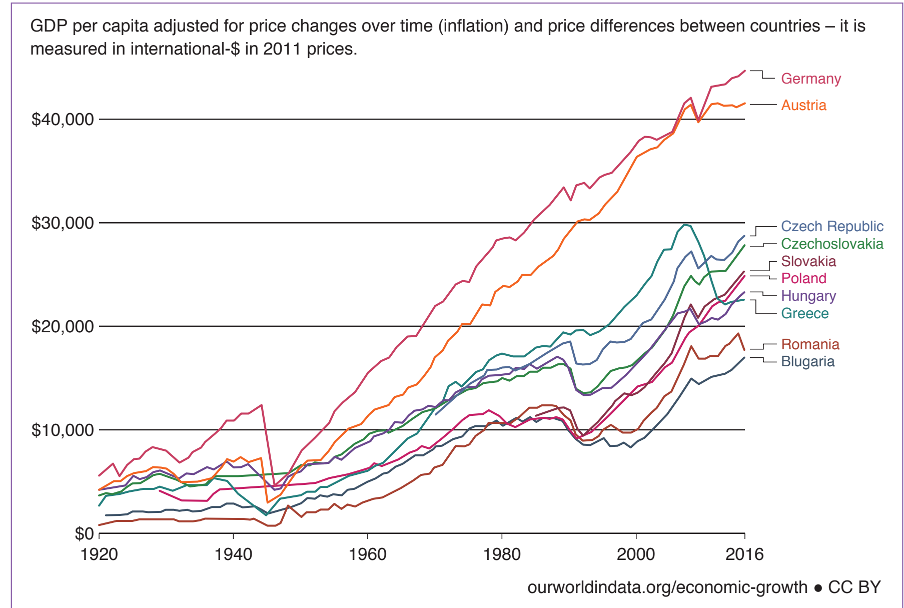
The economic and political developments of 1989-1999 were a restoration of normal economic conditions, not a "transition" to a far-fetched, problem-free social order. The "normality" of this should be understood in the economic policy terms stated by Janos Kornai ("What the Change of System from Socialism to Capitalism Does and Does Not Mean", *The Journal of Economic Perspectives*, Vol. 14, No. 1, Winter 2000) as a return to political power friendly to markets and private property, hard budget constraints as the lead principle in public finance, buyer-dominated markets with rare and temporary shortages, unemployment as a product of technological change, typical business (not political) cycles, and political pluralism and competition. Of all these, only political liberalization was fast and costless.

This restoration of normality came at the price of the liquidation of inefficient and loss-making state sectors, a restructuring that resulted in a severe loss of prosperity. In the first half of the 1990s, the level of GDP per capita in these (and all other post-Communist) countries had fallen to below the world average. By the time Central European countries joined the EU in 2004 (Bulgaria and Romania became members in 2007), they were already at least 30% richer in terms of GDP per capita than the rest but twice as poor as the Western part of the continent.

The *Chart*, based on statistics from Our World in Data by Oxford University, shows details of GDP per capita in Central European countries over a period of 100 years, comparing their economic development with neighbors like Greece, Austria and Germany. One can see that at the end of World War II, Central Europe was at comparable level of GDP per capita – still poorer but in a more advantageous relative position to its neighbors.

In 1945, Bulgaria (today the poorest country in the EU) was only 30% less prosperous than Austria, but better than Greece and even

CHART
GDP per capita, 1920 to 2016



Note: These series are adjusted for price differences between countries based on only a single benchmark year, in 2011. This makes them suitable for studying the growth of incomes over time but not for comparing income levels in countries.
Source: Maddison Project Database (2018)

twice better than Romania. In 1948, Czechoslovaks ($5,800 per capita GDP) were more prosperous than Germans ($5,700) and Austrians ($3,500), and Hungarians ($5,900) were 40% better off than Austrians, while Bulgaria was already 30% worse off than Greece (parts of which Bulgaria occupied as an ally of Germany from 1941 to 1944). There is no data on war-torn Poland but it is well known that it was additionally robbed by the Soviet Union, along with other Central European countries: on the pretext of reparations, irrespective of whether a country was an ally of Germany or invaded by the Nazis, industrial facilities were dismantled and shipped to the USSR. This period of Poland's economic history is well documented by Anne Applebaum in her *Iron Curtain: The Crushing of Eastern Europe, 1944-1956* (Penguin, 2012).

TABLE

Per capita GDP at PPP

(US$1,000, 1996 & 2019)

Country	1996	Country	2019
Germany	34.8	Germany	55.0
Austria	32.3	Austria	54.0
Greece	20.3	Czech Rep.	39.3
Czech Rep.	18.6	Slovakia	37.3
Hungary	14.0	Hungary	34.5
Slovakia	12.2	Poland	33.5
Poland	11.6	Greece	30.5
Romania	10.4	Romania	27.8
Bulgaria	8.4	Bulgaria	24.6

Source: World Bank

Pre-Pandemic Golden Age

In 1999 the restoration process was over and these six countries plus Estonia, Latvia, Lithuania and Slovenia set out on a path to join the EU, benefiting from a market of 500 million consumers, low transaction and unit labor costs, the rule of law and resulting foreign direct investment (FDI). UNCTAD's Inward FDI Performance Index of 2007 and 2008 shows Bulgaria in second place in the world after Hong Kong as an investment destination (UNCTAD 2008 Investment Report: https://unctad.org/system/files/official-document/wir2008_en.pdf).

Despite ups and down and remaining differences between themselves, the Central European countries enjoyed a period of a prosperity without parallel in their entire history. Journalist Shaun Walker wrote in *The Guardian* on Oct. 26, 2019: "Central and Eastern Europe over the past 30 years has witnessed one of the most dramatic economic spurts of growth that any region of the world has ever experienced. People live longer, healthier lives. Air quality is better, and individuals are on average twice as wealthy." He also quoted Polish economist Marcin Piatkowski: "The whole region has been successful, as reflected in the fact that on average, no Bulgarian, or Romanian or Pole has ever lived better than they do now, both in absolute terms and in relative terms compared to the West."

The average economic growth rate of all European post-Communist economies from the end of the 1990s to 2009 was 2.5-3 times higher than the average growth rates of the EU or North America.

The 2009 recession in the region was often sharp (in Romania and Slovakia by more than 5% of GDP, in Bulgaria, the Czech Republic and Hungary by less than 5%, and just a slowdown in Poland) but short-lived. Eurostat data shows that economic growth resumed in the spring of 2010, and by 2015 the same comparative growth pattern *vis-à-vis* Western Europe was restored; for Poland and Romania at the level of 4-5% of GDP, and for the rest of the region (except the Czech Republic) at 3-4%. Post-2009 recession employment rates in Eastern Europe are at their highest historic levels, wages have grown relatively fast and comparative advantages in unit labor costs have disappeared.

According to Eurostat labor force surveys, in the years between 2015 and the end of 2019 the unemployment rate had shrunk by 2.5 times in Bulgaria, the Czech Republic (with the lowest rate in the EU at 2%), and Poland, and by two times in Hungary, Romania and Slovakia. The highest regional rate is in Bulgaria at 4.2% (6.7% in the EU).

The *Table* gives the numbers of the historic "leap forward" by Central Europe. It was triggered by regions' dismantling of central planning around 1996 and the 15 years of EU membership (2019) in terms of GDP per capita (at purchasing power parity). The comparison is again between the economies of Central Europe and Austria, Germany and Greece. Greece had lost the bulk of its previous advantage, having defaulted on its foreign in debt in 2011 and entered a long period of recession. Other countries moved beyond the $30,000 per capita GDP threshold or approached it (Romania), except for Bulgaria.

For this period of 25 years, Austria, Germany and Greece had improved their GDP per capita (at PPP) by 50% on average (Austria by 67%). For Slovakia the improvement was 3.1 times, 2.92 times in Bulgaria, 2.88 times in Poland, 2.67 times in Romania, 2.46 times in Hungary, and 2.1 times in the Czech Republic.

However, irrespective of the success of the years of EU integration, the difference between Central Europe's well-being and that of the "old" EU members remains noticeable. It drains human capital to the West and correlates with the situation in the domestic labor markets and the level of productivity.

Covid-19 Impacts

At the start of the pandemic, its social and economic costs were relatively mild. By the end of May-September 2020, Eurostat data suggested the following regularities:

- Unemployment in the region grew by 25-35% (30-35% in Bulgaria, Poland and Romania) but remained less pronounced than the EU average, which approached 8% by June. The pace of new job creation had slowed down marginally for the EU from 1.9% to 1.7% of the employed from the first to the third quarter

of the year. In the Czech Republic and Hungary the demand for labor in September was higher than the EU average – 5.3% and 2.1% respectively but less than 1% for the rest of the countries.

- As mentioned above, unit labor costs in Central Europe have been registering an uptrend in the last five years; in 2019 the rate was above 10% on an annual basis, with Bulgaria and Romania growing "only" by 6% and 7.7% respectively.
- In terms of the expected GDP decline (as indicated by the EU 2020 Autumn forecast), Poland is the best performing EU country in Central Europe, at -3.6% of GDP in 2020 and a projected recovery of 3.3% in 2021 (almost restoring the "losses" of the last year).
- All other countries are not expected to fully recover in 2021; provided there is no severe third wave of the pandemic, the return to the pre-pandemic GDP levels will come in 2022.
- For Bulgaria the estimated 2020 GDP contraction is 5.1%, and 2021 recovery 2.6%. For Hungary it is -6.4% and +4%; Romania -5.2 and +3.3%; the Czech Republic -6.9 and +3.1%; and Slovakia -7.5% and + 4.7% respectively.
- All countries except Slovakia are seen as better GDP performers than the EU average, where the overall decline in 2020 is expected to reach 7.4%, with the 2021 recovery at 4.1% of GDP.
- Generally speaking, the public finances of Central European countries are better positioned to deal with the negative impacts of the pandemic. For the three years before 2020, Bulgaria registered a comfortable fiscal surplus of almost 1.7% of GDP and the Czech Republic 0.9%. Hungary, Slovakia and Poland's budget deficits were relatively negligible at 2.17%, 0.8% and 0.7% of GDP respectively. Only Romania had an average fiscal deficit of 2.9% (4.4% in 2019) of GDP, still under the 3% of GDP threshold requirement.
- In 2019, all countries had government debt-to-GDP levels considerably below the EU average of 77.6%: Bulgaria at 20.2%, the Czech Republic 30.2%, Romania 35.4%, Poland 45.7%, Slovakia 48.5%, and Hungary 65.4%. These levels of government debt remained until July 2020, while the EU average level had risen to 87.6% of GDP.

The lowest ratios of EU countries' government debt to GDP at the end of the second quarter of 2020 were recorded in Estonia (18.5%), Bulgaria (21.3%) and Luxembourg (23.8%). The debt and fiscal position of Central European countries is not expected to raise their costs of borrowing. In fact, EU and European Central Bank policies led to unprecedentedly low costs of borrowing and Bulgaria, Hungary and the Czech Republic did borrow on the eve of the second wave of the pandemic in October 2020. For the other countries the share of debt somewhat declined. The government debt-to-GDP ratio for the region as of mid-January 2021 is: Bulgaria 24.3%, the Czech Republic 30.8%, Hungary 66.3%, Poland 44%, Romania -35.2% and Slovakia -48% of GDP.

Health Systems Under Pressure

The above quoted GDP assessments and forecasts changed at least three times during the year. The overall methodology did not seem fit to take into account the impacts of restrictions on the human and physical factors of economic life caused by quarantines, lockdowns and transport and travel complications associated with the pandemic. In many respects recovery will depend on Covid-19, vaccination efficacy and the health and economic policies of the countries themselves and the EU.

In the first wave of the pandemic the Central European countries registered relatively modest human life losses from Covid-19. By the end of May, deaths per 100,000 residents were 6.3 in Romania, 5.2 in Slovakia and Hungary, 3 in the Czech Republic, 2.7 in Poland, and 1.9 in Bulgaria. Only Greece fared better with 1.6 fatal outcomes per 100,000 citizens. In Germany and Austria the indicator was 10.1 and 7.3 respectively, and several times higher in many other countries which were among the best in 2019 Global Health Security Index.

As a result of the second wave of the pandemic the countries of Central Europe were already among the most severely hit members of the EU. According to the statistics of the European Centre for Disease Prevention and Control, by the last week of 2020 the Czech Republic had registered the highest number of deaths per 100,000 residents at 1,119.19, followed by Slovakia at 674.5, Hungary at 472.73, Poland at 316.67, Romania at 253.1 and Bulgaria at 160.37.

In is not exactly clear why the pandemic was not contained before the second wave of Covid-19 hit the region. Central European healthcare systems seemed well equipped with hospital beds and healthcare personnel at the start of the pandemic. The statistics for beds (the latest available are for 2017) showed Bulgaria leading with 616.8 beds per 1,000 citizens; Germany next with 601.5 beds; Romania with 525.3; Slovakia with 490.7; Poland with 485.1; and Hungary with 427.1 beds. The lowest number of beds was in the Czech Republic at 410.9, but even this number is significantly larger than the average for the EU of 372.2 beds.

Healthcare personnel statistics for physicians per 100,000 residents and ratios between "specialists" and "General Practitioners" (2012-2017) for the majority of the new member states and Central European countries are somewhat advantageous but there are no leading positions. Only Poland and Slovakia had fewer physicians per 100,000 residents (in 2017) than the average for the EU.

The problem in all countries but particularly in Bulgaria was, perhaps, the "quality of beds", and the overall organization and financing of healthcare. Pandemics are difficult to predict but even more difficult is to plan the finance to fight them in normal times.

In Central Europe, the number of beds is relatively high because many state and municipal hospitals were not closed or renovated. The medical institutions of pre-1989 are still there, coexisting with recently established private hospitals. The medical equipment and overall facilities are often of better quality in private hospitals than in public ones, but private hospitals lack "universality" because their

business strategies in the last 20 years were mostly niche oriented.

The matter requires further study on how the system functioned under pandemic pressure in individual countries. But it seems that everywhere the difference between hospitals led to a cumbersome reaction in the first weeks and months of the pandemic. Most pressure was taken by the public segment of the system and there was a delay in securing the involvement, cooperation and information flow between institutions in the entire healthcare and counter-pandemic process.

The promising statistics of the first months of the pandemic and quantitative data were misleading in many countries. In Central Europe, but not only there, time had been lost by the authorities in allocating speedy and sizable state budgets for both private and public hospital training, salaries, equipment, sample testing and information exchange that would have at least prevented the worsening of the situation due to the lack of experience, knowledge and personnel.

One indicator that demonstrates how mature a healthcare system is, is the share of out-of-pocket payments (OPP) for medical care by residents of the countries. It is defined as a percentage of total current health expenditure. Most Central European countries have far from best practice. According to Eurostat data (2012-2017), the picture is as follows:

- Only the Czech Republic is around the average EU OPP at 14% (in France below 10%, Germany 14%, Luxembourg around 11%, Sweden and the United Kingdom 15%);
- Estonia, Slovenia and Croatia are very similar to these countries; Lithuania resembles Mediterranean countries, where OPPs are well above 30% of health payments;
- All other countries, except Bulgaria, are in the belt of between 20% and 30% in payments for medical services: Romania at 21% (improving from 23% at the beginning of the period); Poland at 23% (average); Hungary at 27% in 2017 (down from approximately 30% in 2012); Slovakia at 18.5%, (improving from 23% before 2014);
- It looks as if the levels of OPPs in Central Europe are approximating the level in Austria (19% on average for the period), Finland and Ireland;
- The outlier in the EU is Bulgaria where OPPs are firmly at the level of 47% in the last 10 years; only Latvia has a 40% OPP on average.

In theory, OPPs may be used to develop better health services, but so far this does not seem to be the case in Central Europe.

Recovery Plans & Risks

The pandemic was and still is a test of how robust Central European countries and governments are to unexpected shocks and profound uncertainties like those of 2020. It looks as if the recession caused by the pandemic coincided with a cyclical downturn trend that was in the making and was expected by risk analysts.

The health and economic statistics suggest that Central European countries have been and could be more resilient to such challenges than the EU average. On the other hand, however, the region's economic indicators for at least the last five years suggest that they are losing potential. Overall, economic inertia since the recession of 2009-2010 has registered less potential for economic growth (2.5-3.5% of GDP per annum compared to above 5% in the period prior to the 2009 recession), job creation (due perhaps to rising unit labor costs but also unfavorable demographics) and investment growth (due to much lower FDI).

Eurostat data on labor productivity per person employed and hours worked for the last five years tell an important part of the story. In the 2015-2019 period they improved relative to the EU average from 44.6% to 48% in Bulgaria; from 80.5% to 85% in the Czech Republic, from 74.6% to 79.7% in Poland and from 58.6% to 73% in Romania. In Hungary the level of productivity declined to 70.7% from the EU average of 71.9% in 2015, and in Slovenia from 83.6% to 73%.

The better fiscal and government debt position of the Central European countries might be helpful in a post-pandemic recovery. However, actual recovery will depend on how policies are implemented by the governments of the individual countries. The challenges ahead are far from trivial.

On the one hand, there is a massive 1.8 trillion euro post-Covid-19 recovery plan by the EU. Its beneficiaries are first of all the Central European countries and Croatia. For Croatia the ear-marked allocation is 28% of its 2020 GDP, for Bulgaria 24%, and for Slovakia, Romania and Poland 17%, 15% and 13% of GDP respectively. Next comes Hungary at 12% and the Czech Republic at about 7%. The national plans are still being drafted but what information is available tells us that the underlying ideas (often dominated by construction projects) are not likely to make a difference in productivity and FDI.

On the other hand, the governments of the EU are incentivized to become an investor of last resort, and the EU itself is evolving into a key investor. After April this year the EU will have the right to increase revenues from its own resources by about four times. A precondition for that is the agreement of the member states to introduce elements of European common fiscal policy – a carbon tax of sorts, a "harmonized" tax base and a common way of calculating minimum wages. These policies have been discussed since 2018 and were approved by the European Council in May 2020. For the time being it is hard to imagine how the individual governments of Central Europe will address these three elements and other limits to competition within the EU. JS

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